In the Supreme Court of the United States

OCTOBER TERM, 1973

No. 73-105

SUPERIOR PINE PRODUCTS COMPANY, PETITIONER

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF CLAIMS

MEMORANDUM FOR THE UNITED STATES IN OPPOSITION

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1. Petitioner instituted this tax refund suit in the United States Court of Claims, contending that the proceeds from a timber contract were long-term capital gains. The court upheld the determination by the Commissioner of Internal Revenue that those proceeds were ordinary income, on the ground that petitioner retained no economic interest in the timber, as is required for capital gains treatment under Section 631(b) of the Internal Revenue Code of 1954, 26 U.S.C. 631(b). Petitioner here renews its claim that it had retained an economic interest in the timber.

The timber contract in question grants to the St. Regis Paper Company the right to possession for 60 years of more than 200,000 acres of timberland owned by petitioner plus the right to remove annually an amount of timber equal to the average annual growth. Under

the contract, St. Regis is required to make annual payments to petitioner, the amounts of which are determined by a complicated formula[1] without regard to the amount of timber actually cut.

2. Section 631(b) provides that the disposal of timber "under any form or type of contract by virtue of which [the] owner retains an economic interest in such timber" is to be treated as the sale of property used in the taxpayer's trade or business for purposes of Section 1231 of the Code. That Section provides that the gains and losses on such sales are to be aggregated; if such sales show a net gain, that gain is treated as a capital gain. In this case, if petitioner's receipts under the contract with St. Regis had been treated as proceeds from the sale of property used in its business, the entire amount of such receipts would be taxed as long-term capital gains and not as ordinary income. Thus the character of petitioner's gain turns upon whether it had retained an economic interest in the timber disposed of during the years in question.

The concept of a retained economic interest first arose in connection with the allowance for depletion; such allowance is available only to taxpayers having an "economic interest" in the minerals in place or in standing timber. See *Commissioner* v. *Southwest Exploration Co.*, 350 U.S. 308; *Palmer* v. *Bender*, 287 U.S. 551. The existence of an economic interest depends on two factors: (a) the taxpayer must have a capital investment in the

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[1]The annual payment is determined by multiplying the property's average annual timber growth expressed in cords (but not less than 150,000) by double the wholesale commodity price index (based upon 1947=100). However, the annual payment may not fall below $150,000. See Pet. App. 16.

standing timber, and (b) he "must look *solely* to the [severance of timber] for a return of his capital * * *." *Commissioner* v. *Southwest Exploration Co., supra,* 350 U.S. at 314 (emphasis in the original). Petitioner satisfies neither of these tests.

a. The contract between petitioner and St. Regis was entered into in 1947. Petitioner had a capital investment in the timber then standing on its property. However, that stand of timber is not involved here. This case involves amounts received by petitioner in the years 1965 through 1967, after it had been fully compensated for all timber in which it had had an investment in 1947.[2] Thus, to the extent that any amounts received by petitioner under the contract were on account of the disposal of timber, the timber in question—*i.e.*, the timber which had matured for cutting during 1965-1967—was timber in which petitioner had no capital investment. That timber was simply an annual crop in which petitioner as lessor had retained no interest. See *Union Bag-Camp Paper Corp.* v. *United States,* 325 F. 2d 730, 736-740 (Ct. Cl.). However, the court below did not find it necessary to reach this issue, for it decided the case on the ground that the payments received by petitioner were not dependent upon production, the issue to which we now turn.

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[2]The fair market value of the timber standing in 1947 was $7,300,000. Pursuant to Rev. Rul. 62-81, 1962-1 Cum. Bull. 153, the first $7,300,000 received by petitioner under the contract was treated by the Commissioner as proceeds from the sale of business assets under Section 1231 and therefore substantially as long-term capital gains. Whether, in light of the rationale of the court below (see point 2b, *infra*), petitioner was entitled to capital gains treatment of those receipts is not at issue here.

b. The amounts of the annual payments under the contract were determined without regard to production. See note 1, *supra*. As the court below noted (Pet. App. 35), petitioner's income from the contract "was not contingent upon severance of the timber, nor payable * * * solely out of the proceeds from the natural resource itself." Since petitioner was not looking to severance of timber for a return of its capital, the court below correctly determined that petitioner had not retained the necessary economic interest.

Petitioner claims (Pet. 6-9) that the decision below nevertheless conflicts with *Hartman Tobacco Co.* v. *United States*, 471 F. 2d 1327 (C.A. 2), and *Wood* v. *United States*, 377 F. 2d 300 (C.A. 5), certiorari denied, 389 U.S. 977.[3] But those cases—both of which involved contracts for the extraction of sand and gravel—are factually distinguishable in the important respect that the amounts of the payments there were determined by reference to actual extraction. The contracts in those cases provided for payments based upon the amount of sand and gravel extracted, subject to an annual minimum. Thus although the payments were not wholly contingent upon production, they were primarily so.[4] The results in those cases do not conflict with the de-

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[3] Petitioner also claims a conflict with *Commissioner* v. *Southwest Exploration Co.*, *supra*. But the issue decided there was whether owners of land used in slant-drilling for oil located under adjacent land had a capital investment in the oil in place, whereas the court below did not even reach the issue whether petitioner had a capital investment in the timber which matured for cutting during the years in question. Thus there is no conflict between *Southwest Exploration* and the decision below.

[4] For example, in *Wood*, the contractual minimum was $15,000 per year but the actual annual payments based upon production averaged over $100,000.

cision below, where actual timber severance was irrelevant to the determination of annual payments. Moreover, those cases involved depletion of a finite resource rather than, as here, the harvesting by a lessee of a continuously replenished annual crop (see point 2a, *supra*). In short, the taxpayers in *Hartman Tobacco* and *Wood* were in essence *selling* gravel, whereas petitioner was in essence *leasing* timber cropland. The rentals received by petitioner were properly treated as ordinary income by the court below.

For the foregoing reasons, it is respectfully submitted that the petition for a writ of certiorari should be denied.

ROBERT H. BORK,
Solicitor General.

AUGUST 1973.